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Mr Malcolm Roberts
Chairman
Queensland Competition Authority
GPO Box 2257
Brisbane QLD 4001

By email: electricity@qca.org.au

Dear Mr Roberts

Regulated Retail Electricity Prices 2013-14

Thank you for the opportunity to make a submission to in response to QCA's *DRAFT Electricity Price Determination 2013-14.*

CANEGROWERS is very concerned about the proposed 17.5% increase in electricity prices in those electricity tariffs principally used to pump agricultural irrigation water. The proposed regulated price increase is much higher than the rate of increase inflation (CPI is currently 2.2%) and far outstrips the rate of increase in other farm input prices, all of which (other than labour and government fees, taxes and charges) have fallen in recent years according to ABARES (Figure 1). The impact of the electricity price hikes, particularly on those impacting on the trade exposed agricultural sector, is becoming severe and is threatening the viability of sugarcane growers.

Simply increasing prices to provide a guaranteed return on electricity network investments is not an efficient response to escalating costs associated with ageing assets, changing peak demand loads and the impact of rapidly changing generating and storage technologies on demand. Failures in the regulatory framework, including in the application of national competition policy rules, have provided incentives to over-invest. In a rapidly changing environment, the electricity industry, network owners and regulators need to do more to meet the challenges at lower cost.

The regulatory framework has shifted the risk of poor investment decisions from the network owner (the Queensland Government) to electricity users. With incentives to expand their regulated asset base (RAB), Ergon and Energex have delivered higher profits, fees and taxes to the network owner. However, the significant boost in revenues to the Queensland Government has come at a cost – a significant decline in the international competitiveness of the sugar and other trade exposed industries.

Recommendations

CANEGROWERS recommends:

1. Introduction of a mechanism within the Ergon distribution network to increase retail competition.
2. Removal of the proposed artificial, arbitrary and unnecessary 25% price escalation on so-called obsolete tariffs.
3. Introduction of a worthwhile off-peak differential by discounting network charges and realising the true cost of electricity in the National Energy Market (NEM).
4. Reversal of the onus of retail cost build-up to reflect what would occur in a competitive market.

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5. Removal of the impact of unnecessarily high network reliability standards from electricity tariffs for irrigation.
6. Advising the Queensland Government of the benefits reducing with WACC will have on placing downward pressure on electricity prices.
7. Advising the Queensland Government of the benefits associated with removing the cost of the Solar Bonus Scheme from NSP balance sheets.
8. Retaining access to transitional tariffs and allow new connections to these tariffs over the transitional period.
9. Allowing access to T12 for agricultural irrigation users.

Electricity prices are too high

The proposed 17.5% price hike is simply too high. If implemented, the increase will mean electricity prices for irrigation water use will have increased by 90% (almost doubling) in seven years. Over the same period, most other farm input prices have fallen by 20%.

Highly trade exposed, sugarcane growers are price takers. In 2013-14 world sugar prices are expected to decline by 17%, reducing sugarcane prices and farm incomes concomitantly even before the adverse impact on production of *ex-tropical cyclone Oswald* has had on expected 2013-14 production for many in south east Queensland. Without an ability to pass electricity price increases on to downstream users or final consumers, sugarcane growers will see their incomes fall and the value of their farms decline as a direct result of the QCA's proposed regulated electricity price increases. In the Burdekin average farm income would fall by 25.9% and in south-east Queensland by 6% (Table 1).

Equally, there are no sound reasons for agricultural irrigators to share in the costs associated with government policy decisions related to the Solar Bonus Scheme or network security standards (see below). These costs should be shared across the broader tax base. When imposed on industries (such as sugar) facing world market competition, the costs erode international competitiveness.

The asset write downs that should be occurring in the electricity network and be borne by the network owners have not disappeared, nor have the costs associated with government policy decisions; they are being transferred to electricity users. As a result, the overall competitiveness of the Queensland economy is declining. It is important that this outcome is not left uncommented by the QCA, whose principal task is to enhance the competitiveness of the Queensland economy.

CANEGROWERS acknowledges the constraints contained in the QCA's terms of reference. However we encourage QCA to acknowledge the impact of its electricity price determination and the regulatory framework on the international competitiveness of Queensland's export industries in its Final Determination.

The adverse impact of rapidly rising government fees and charges on the cost of irrigated agricultural production must be addressed if the boost to the Queensland economy envisaged in the Government's four-pillar economy policy is to be realised. Delaying the radical increases proposed in the Draft Determination to the latter part of the delegation period would help avoid electricity price volatility. Such a decision would be consistent with the Queensland Government's view, "that anticipated future decreases in network charges could allow for a smoothed price path, thereby enabling larger increases to be postponed to the end of the Delegation period" (Draft Determination, p68).

Representations to the Queensland Government

CANEGROWERS understands the constraint, to follow the N+R cost build up, imposed on QCA by the delegation from the Minister for Energy and Water Supply. However, the delegation also requires the QCA to scrutinise the major cost drivers and provide the Queensland Government with advice on how these costs could be managed. The Draft Determination is silent on many of the issues on which QCA advice could be provided.

Table 1: Impact of electricity price increases on farm business income

Production		Burdekin		Bundaberg	
Cane produced	*t*	15183		9450	
Area harvested	*ha*	132		105	
Yield	*t/ha*	115		85	
Cane Sugar Content	*CCS*	15		14	
Proportion irrigated	*%*	100		95	
		Burdekin		**Bundaberg**	
Income					
Sugar price	*\$/t*	518.16		518.16	
Cane price	*\$/t*	51.92		47.26	
Total receipts	*\$*	788,364		446,601	
Expenses					
less* Cash costs *(excluding electricity)	*\$*	549,671		257,043	
Electricity costs	*\$*	26,485		13,423	
Total Costs	*\$*	576,156		270,466	
Farm cash income	*\$*	212,208		176,135	
***less* Nominal wage for grower**	*\$*	60,000		60,000	
Farm business income	***\$***	152,208		116,135	
2013/14 Finances		**Burdekin**		**Bundaberg**	
Income					
Sugar price	*\$/t*	430		430	
Cane price	*\$/t*	43.20		39.33	
Total receipts	*\$*	655,846		371,621	
Income reduction from world price *(from \$518/t)*	*\$*	**132,518**		**74,980**	
Δ Annual receipts from 2011/12	***%***	**-17%**		**-17%**	
		Electricity increase		*Electricity increase*	
Expenses		*0%*	*17.50%*	*0%*	*17.50%*
less* Cash costs *(excluding electricity)	*\$*	549,671	549,671	257,043	257,043
Electricity costs	*\$*	26,485	31,120	13,423	15,772
Total Costs	*\$*	576,156	580,791	270,466	272,815
Farm cash income	*\$*	***79,690***	***75,055***	101,155	98,806
***less* Nominal wage for grower**	*\$*	***61,800***	***61,800***	61,800	61,800
Farm business income	***\$***	***17,890***	***13,255***	39,355	37,006
Δ Farm business income (FOR INCREASE IN ELECTRICITY COST)			***-25.9%***		***-6.0%***

Some examples include:

1. *Competitive Neutrality and Weighted Average Cost of Capital (WACC)*
   At the most basic level, allowable revenues for Queensland's NSPs (Energex, Ergon and Powerlink) are calculated by using the Australian Energy Regulator's (AER) WACC x RAB formula. Evidence suggests both the WACC and RAB are inflated.
   - It may be the case that some of the capital Ergon and Energex use was financed at the height of the GFC by Queensland Treasury Corporation (QTC) and there would be expense incurred in breaking these commitments.

However, the rate at which QTC charges Ergon and Energex for the borrowings significantly exceeds its cost of raising the funds; and, recent capital raisings by QTC on behalf of Ergon and Energex have occurred in a declining interest rate environment, yet the full WACC is applied to this new capital as well as the existing capital base.

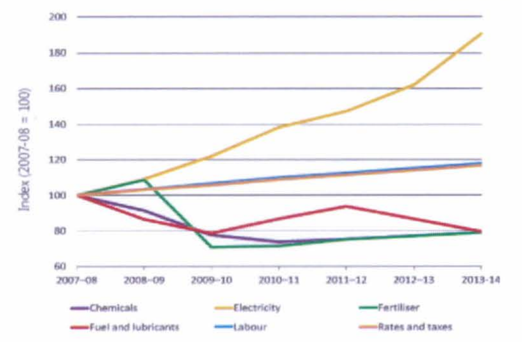
There is scope for the QTC on-lending margin to Ergon and Energex to be reduced, outside of the AER process and without breaking existing QTC bond covenants to take account of these factors and the dynamic commercial environment (Figure 2). Such action would have a real impact on underlying costs which would flow through to lower network charges (Table 2).

- As noted in the Draft Determination and above, the Queensland Government is anticipating reductions in network charges. Over time, such reductions would also contribute to a smaller RAB.

For these reasons, and with 63% of Energex's network charges used to recover the regulated return on assets, the capital charges allowed under the AER framework have inflated the N component of the electricity tariff base that QCA has been asked to treat as a pass through for price determination. A moderation in the network charges will place significant downward pressure on electricity prices in Queensland.

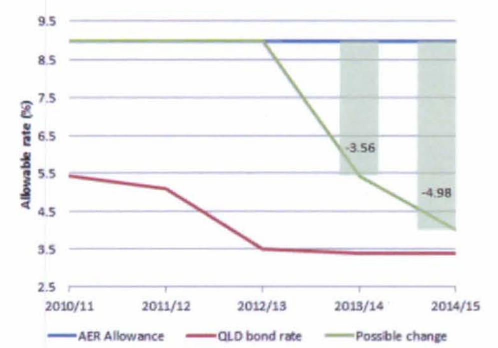
As Queensland's authority on the impact on competition of government regulations, it is important that the QCA draw attention to these issues in making its Final Determination.

Figure 1: Farm input prices



Source: QCA, ABARES

Figure 2: Cost of Capital – Energex



Source: AER; Qld Treasury Corporation

Table 2: Tariff 22 – impact of Energex network charges

Component		CAP 8.98%	CAP 5.42%	CAP 3.4%
Fixed	*c/day*	71.299	54.813	45.459
Peak	*c/kWh*	12.934	9.943	8.247
Off-peak	*c/kWh*	8.571	6.589	5.465
N price reduction	%	0	23	36

CAP = AER allowable capital cost

2. *Transfer of Capital Risk*
   Risk is inherent in the provision of network services. Two of the principal risks are:
   - Changing technology – generating and storage; and
   - Demand forecasting.

   In competitive industries and in non-government owned but regulated natural monopolies these risks are, in large part, borne by the asset owners. Governments tend to impose much stricter regulatory disciplines on businesses they do not own.

   As noted above, the current network pricing framework overseen by the AER simply transfers capital risk associated with over investment in networks from the owners to the users.

   It is important QCA acknowledge the impact of the risk pass through on these industries, such as irrigated agriculture, which are unable to pass the price hikes onto their customers and take it into account when determining retail electricity prices.

3. *Solar Bonus Scheme*
   One of the largest factors adding "cost" to network tariffs structures is the government's policy decision that requires the cost of the state's *Solar Bonus Scheme* to be borne by network service providers. In its Draft Determination, QCA reports this policy decision will account for 9.2% of network costs in 2013-14, increasing to 29.5% by 2015-16.

   Rather than being a direct cost to government, the policy approach has shifted the cost of the scheme to network service providers. As noted, this has real consequences for electricity prices and the competitiveness of all industries in Queensland's traded goods sector.

   In the interests of boosting the international competitiveness of Queensland industry, it is important that QCA recommends a policy approach to government that is both efficient and transparent.

4. *Security Standards*
   The Queensland Government's mandated N-1 network security standards policy is also placing upward pressure on retail electricity prices. These standards have resulted in over-investment in network assets and inflated the RAB.

   It is important that QCA acknowledges and quantifies the impact of these standards on regulated retail electricity prices in its final report.

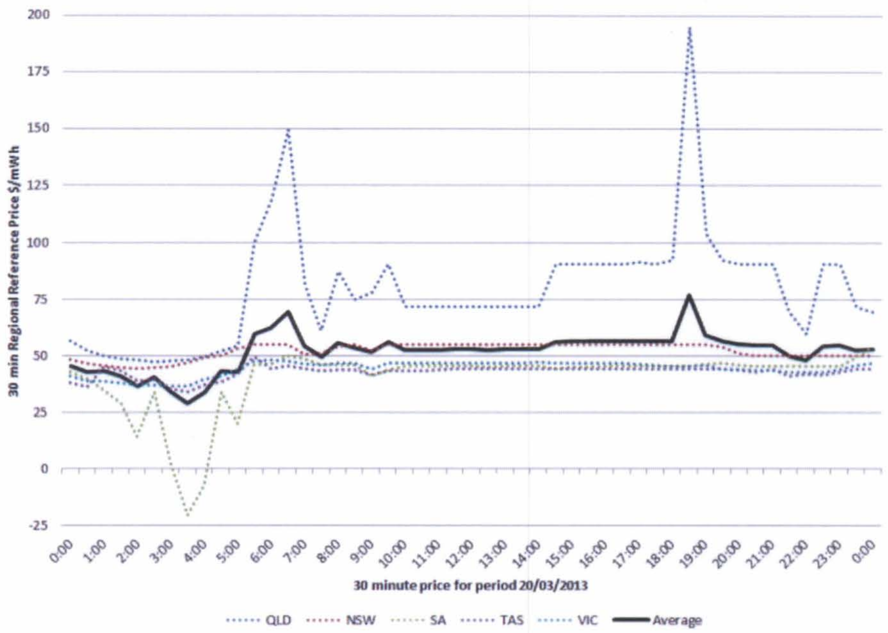
5. *Cost Reflective Pricing*
   Although a robust concept, the application of cost reflective pricing is flawed. Prices contained in the Draft Determination are averages. They do not adequately reflect the price at which generators supply electricity or of network use. There is little discussion of the importance of marginal cost pricing, the issues associated with cost identification and allocation, or of the issues associated with asset valuation amongst others. And, as noted, several costs associated with government policy decisions, have artificially inflated network tariff structures. At the retail level, the costs applied are estimates and these have been deliberately inflated to "enable competition". Yet in the Ergon distribution network there is no retail competition.

   It is important that QCA acknowledges the short comings of its methodology and the lack of robust cost data and identifies the likely impact of these deficiencies on regulated retail electricity prices in its final report.

Energy Costs

The QCA's application of standard, flat energy pricing does not reflect true energy prices in the national energy market (NEM). Time of Use (ToU) signalling exists in the NEM, particularly in Queensland (Figure 4). It is important that real peak/off-peak price differences in electricity generation be reflected in regulated retail tariff structures.

Figure 3: Energy ToU signals exist in the national Energy Market



Source: AEMC

Retail costs

The Draft Determination envisages an increase in the percentage provided for the so-called "headroom" allowance to provide for competition. QCA acknowledges the drivers for network cost increases are largely artificial and driven by policy decisions. Yet it adds a further artifice through a "retail cost catch-up" to provide for further competition compounding the issue. It effectively adds an incentive to increase charges on an already inflated cost base.

Electricity retailers operate in a competitive market. The drivers in that market encourage the pursuit of productivity gains and cost savings. By proposing an increase in the retail margin, the QCA's Draft Determination reduces these competitive pressures and introduces incentives for retailers to increase their underlying cost base and in future determinations seek even higher retail margins.

Competition and Community Service Obligation (CSO)

The cost to government of Ergon's CSO is increasing. This is occurring because of the increasing disparity in efficiency between the Energex and Ergon distribution networks, not because more users are receiving greater subsidies.

The size of the CSO may be an issue for government, Ergon's owners. Its application has become an issue for Ergon's customers. Applied at the retail level, the CSO is a significant impediment to the development of competition at that same retail level.

CANEGROWERS supports a review of the application of Ergon's CSO and encourages QCA to recommend changes that would facilitate the development of retail competition across Ergon's regional network.

Total contributions to government from Queensland's state owned NSP will exceed $2 billion – Energex, Ergon and Powerlink have contributed $842.1 million, $815.4 million and $499 million respectively. It is clear that the CSO to Ergon, net of its payments to government, is much smaller than Ergon's gross payment to government.

Transitional arrangements

CANEGROWERS understands the competing interests placed on the QCA in establishing a suitable period to enable the transition from the so-called "obsolete" irrigation tariffs.

CANEGROWERS strongly supports continued and new access to T62, T65 and T66 over the proposed seven-year transitional period.

Electricity tariffs for irrigation are obsolete because of a change in calculation methodology, not because they are not well used by irrigators. CANEGROWERS is working closely with Ergon, Energex and the AER to develop suitable network tariff structures that will enable use of the N + R methodology in the calculation of irrigation tariffs beyond the transitional period.

QCA's acknowledgement of this work and stressing the importance of network tariffs reflecting user needs and network demands would be appreciated.

The proposed 25% tariff escalation, increasing the proposed price increase from 14 to 17.5% is unnecessary. It increases the impost on users at a time when the State Government is reviewing the Queensland energy sector and the AER *Better Regulation* process has just commenced.

Consistent with the Queensland Government's suggestion that "anticipated future price increases be postponed to the end of the Delegation period" (DRAFT Determination p68), CANEGROWERS recommends removal of the proposed 25% escalation in so-called "obsolete tariffs".

Tariff 12

CANEGROWERS supports broader access to T22 and T12 for irrigation users; both tariffs have a peak and off-peak structure. However, as proposed the tariffs contained in the QCA Draft Determination will not be used by irrigators due to their higher cost structure when compared to existing irrigation tariffs.

With the adoption of CANEGROWERS recommendations, more cost reflective structures for T22 and T12 could be developed, as illustrated in tables 3 and 4 respectively.

Irrigation has a base load and off-peak energy use profile. Given this profile, it is clear that 25% of network costs that relate to infrastructure built to meet the peak demand periods have not been incurred for the benefit of irrigation electricity users. To be cost reflective, the network component of T22 and T12 schedules should be reduced.

In CANEGROWERS suggested T22 and T12 tariff schedules, a 25% reduction in the network component for the peak period has been applied. The 25% reduction has also been applied in tariffs for the shoulder period. A further reduction of 25% (50% in total) applied in the off-peak period for both T22 and T12.

Several other actions can be taken to reduce the total cost-build up:

- Energy costs that reflect the true cost of energy in off-peak times can also reduce the cost of electricity in shoulder and off-peak times. Prices in the above tables have been taken from aggregated NEM prices obtained from the AEMC.
- Retail margin can be removed from fixed costs (as this would not occur in a competitive market environment), rather than increased to 5.4% (as noted above). Regulated pricing

signals should provide retailers an incentive to sell electricity, not fall captive to retailers' argument designed to lock in their profit margins.

The headroom provided for competition should be minimised as a cost. In a truly competitive environment it would be competed away.

Table 3: T22 CANEGROWERS' proposal

Tariff 22 - Time of Use	QCA Cost Reflective			CANEGROWERS Cost Reflective		
Component	Fixed	Peak	Off-peak	Fixed	Peak	Off-peak
	c/day	*c/kWh*	*c/kWh*	*c/day*	*c/kWh*	*c/kWh*
Network	71.299	12.964	8.571	53.47	9.72	3.21
Energy		8.618	8.618		5.947	4.665
Retail	36.704			33.99		
Margin	6.156	1.228	0.98	0	1.00	1.00
Headroom	5.708	1.139	0.908	0	0	0
Total	**119.867**	**23.949**	**19.077**	**87.459**	**16.667**	**8.875**

Table 4: T12 CANEGROWERS' proposal

Tariff 12 - 3part	QCA Cost Reflective				CANEGROWERS Cost Reflective			
Component	Fixed	Peak	Shoulder	Off-peak	Fixed	Peak	Shoulder	Off-peak
	c/day	*c/kWh*	*c/kWh*	*c/kWh*	*c/day*	*c/kWh*	*c/kWh*	*c/kWh*
Network	57.177	19.29	11.737	9.306	42.882	14.467	6.602	3.489
energy		8.618	8.618	8.618		5.947	5.361	4.665
Retail	36.704				33.985			
Margin	5.351	1.591	1.16	1.022	0	1.00	1.00	1.00
Headroom	4.962	1.475	1.076	0.947	0	0	0	0
Total	**104.194**	**30.974**	**22.591**	**19.893**	**76.868**	**21.414**	**12.963**	**9.154**

CANEGROWERS seeks an electricity price determination that delivers prices comparable to those which would result from a competitive market structure. The prices should provide performance incentives and encourage network service providers to reduce their cost structures and not hinder the growth and development of strong internationally competitive export oriented industries such as sugar.

Yours sincerely

[redacted]

Warren Males
Head-Economics